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FISCAL IMPACT STATEMENT

LS 6944 | **NOTE PREPARED:** Jan 20, 2006
BILL NUMBER: HB 1007 | **BILL AMENDED:** Jan 19, 2006

SUBJECT: Various Business Tax Changes.

FIRST AUTHOR: Rep. Harris T | **BILL STATUS:** CR Adopted - 1st House
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State
X DEDICATED
FEDERAL

Summary of Legislation: (Amended) *Single-Sales-Factor Apportionment:* The bill increases, over five years, for purposes of the Adjusted Gross Income Tax, the sales factor used to apportion business income. The bill eliminates the property factor and payroll factor that are also used in apportioning income for taxable years beginning after December 31, 2010.

Motion Picture/Audio Production Sales Tax Exemption: The bill provides that certain transactions involving tangible personal property are exempt from Sales Tax if the person acquiring the property acquires it for the person's direct use in the direct production of a motion picture or an audio production. It excludes obscene motion pictures from the definition of motion picture for purposes of the Sales Tax exemption.

Hoosier Business Investment Tax Credit (HBITC): The bill deletes the January 1, 2008, deadline for a purchase of motion picture or audio production equipment to be eligible as a qualified investment for purposes of the Hoosier Business Investment Tax Credit. It extends by five years (from December 31, 2007, to December 31, 2012) the date by which a qualified investment must be made in order to be eligible for the HBITC. It also provides for automatic extensions of that date in five-year increments unless the General Assembly enacts a law that terminates the automatic extensions.

Effective Date: (Amended) January 1, 2006 (retroactive); July 1, 2006; January 1, 2007.

Explanation of State Expenditures: (Revised) *Department of State Revenue (DOR):* The DOR will incur additional expenses to revise tax forms, instructions, and computer programs due to the transition to a single-sales-factor apportionment formula and the motion picture/audio production Sales Tax exemption. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: (Revised) *Single-Sales-Factor Apportionment: Summary:* The bill provides for a 5-year phaseout (from 2007 to 2011) of the payroll and property factors used to apportion a corporate taxpayer's adjusted gross income (AGI) to Indiana under the AGI Tax. Beginning in 2011, AGI of corporate taxpayers would be apportioned solely on a single sales factor. Based on taxpayer simulations and the current forecast of corporate revenue collections, the change to single-sales-factor apportionment is estimated to result in a net decrease of revenue from the corporate AGI Tax as outlined in the table below.

Fiscal Impact	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Low Range	($2.0 M)	($6.1 M)	($10.4 M)	($14.9 M)	($25.3 M)	($34.0 M)
High Range	($3.1 M)	($10.0 M)	($17.6 M)	($26.2 M)	($45.9 M)	($63.9 M)

Background: The bill phases out the payroll and property factors for purposes of computing corporate Adjusted Gross Income (AGI) Tax. The apportionment formula is used to determine Indiana adjusted gross income for corporations whose income is derived from sources both within and outside Indiana. Currently, a three-factor apportionment formula is used including property, payroll, and sales (also called receipts) to allocate business income to the state. The sales factor is double-weighted so that the payroll and property factors combined represent 50% of the apportionment factor, with sales representing the remaining 50%. The current apportionment formula is shown below.

$$\left[\frac{Indiana\ \ Property}{Total\ \ Property}+\frac{Indiana\ Payroll}{Total\ Payroll}+2*\left(\frac{Indiana\ Sales}{Total\ Sales}\right)\right]\div 4$$

The bill phases out the payroll and property factors by 10% each year from 2007 to 2011. The phaseout schedule is as follows:

	Sales Factor Weight	Combined Weight of Payroll and Property Factors
Current	50%	50%
2007	60%	40%
2008	70%	30%
2009	80%	20%
2010	90%	10%
2011 and after	100%	0%

After the phaseout of the payroll and property factors in 2011, a corporation's income would be allocated to the state based on its Indiana sales as a proportion of its total sales in the United States. The single-sales-factor apportionment formula is presented below:

$$\frac{\textit{Indiana Sales}}{\textit{Total Sales}}$$

Corporate AGI taxes are distributed to the General Fund. In FY 2005, $608.4 M was collected in corporate AGI Taxes.

Methodology: The fiscal impact is estimated based on a taxpayer simulation using 2003 Corporate AGI taxpayer information (from the IT 20 returns) and recalculating tax liabilities based on the changes in the apportionment formula. The revenue estimates above are based on the first year that corporate taxpayers were taxed solely on adjusted gross income and not gross receipts. *The extent to which this change in tax policy will alter the corporate tax base and future revenue collections is unknown*. Based on the simulation, the net revenue loss from moving to single-sales-factor apportionment is not the result of all corporate taxpayers experiencing some decline in tax liability. Rather, it is the additive result of some taxpayers experiencing a decrease in tax liability and others experiencing an increase in tax liability that fails to fully offset the total of the tax reductions. The simulations using 2003 taxpayer data resulted in about 2,300 taxpayers experiencing a decrease in net tax liability after credits and about 4,700 experiencing an increase in net tax liability after credits. The simulations also resulted in nearly 28,500 taxpayers being unaffected by the change to single-sales-factor apportionment.

The low-range estimate is the net impact on tax liabilities assuming that the taxpayers experiencing tax liability increases due to single-sales-factor apportionment would not have additional NOL (net operating loss) deduction amounts or tax credit amounts to reduce these higher tax liabilities. Thus, they would utilize the same NOL deduction amounts and tax credit amounts as reported in 2003. The high range is the net impact assuming that some taxpayers experiencing tax liability increases due to single-sales-factor apportionment will have sufficient additional NOL deduction amounts and tax credits to reduce these higher tax liabilities. *It is important to note that the net revenue loss could potentially exceed the high range if all of the taxpayers experiencing increased liabilities are able to utilize additional NOL deduction amounts or tax credits to reduce these higher tax liabilities to zero.*

<u>The tables below summarize the results of the 2003 taxpayer simulations.</u> The table below shows the extent that single-sales-factor apportionment would have affected 2003 Indiana **apportioned income**. A total of 35,396 taxpayers were used for the simulation, with 7,128, or 20%, experiencing an increase in Indiana apportioned income and 4,034, or 11%, experiencing a decrease in apportioned income. The net effect for these taxpayers was a 6% decrease in Indiana apportioned income. A total of 24,234, or 69%, of all the regular C corporate taxpayers experienced no change in Indiana apportioned income.

Effect of Single-Sales-Factor (SSF) Apportionment on Indiana Apportioned Income - 2003 Tax Data*						
Apportioned Income	**# Affected**	**Apportioned Income - Current**	**Apportioned Income Under SSF**	**Difference**	**% Diff.**	**Avg. Diff.**
Increase	7,128	$1,703.9 M	$2,265.0 M	$561.1 M	33 %	$78,718
Decrease	4,034	$2,287.0 M	$1,473.1 M	($813.9 M)	(36%)	($201,751)
Total Affected	11,162	$3,990.9 M	$3,738.1 M	($252.8 M)	(6%)	($22,645)
No Change	24,234	$1,290.9 M	$1,290.9 M	$0	0	$0

* This table is the effect on corporate taxpayers fully phased-in single-sales-factor apportionment.

The next table summarizes the impact that single-sales-factor apportionment would have had on 2003 **net tax liabilities** (after credits) for the same group of corporate taxpayers. The simulations resulted in 4,678, or 13%, of the taxpayers experiencing a tax increase and 2,309, or 7%, of the taxpayers experiencing a tax decrease. The net decrease in tax liability for all affected taxpayers would have been about 4%. A total of 28,409, or 80%, of the regular C corporate taxpayers would have experienced no change in net tax liability after credits.

Effect of Single-Sales-Factor (SSF) Apportionment on Net Tax Liability After Credits - 2003 Tax Data*							
Tax Liability	**# Affected**	**# of Payers**	**Current Tax**	**Tax Under SSF**	**Difference**	**% Diff.**	**Avg. Diff.**
Increase	4,678	3,950	$116.0 M	$163.6 M	$47.6 M	41%	$10,683
Decrease	2,309	2,136	$156.9 M	$99.5 M	($57.4 M)	(37%)	($13,473)
Total Affected	6,907	6,086	$272.9 M	$263.1 M	($9.8 M)	(4%)	($6,568)
No Change	28,409	8,819	$87.2 M	$87.2 M	$0	0	$0

* This table is the effect on corporate taxpayers fully phased-in single-sales-factor apportionment.

The last table shows the shift in the share of AGI taxes that would have been paid in 2003 by the three groups of corporations. The simulation results indicate that the share of taxes paid by taxpayers experiencing an increase in liability goes from 32% to 47%. The share for corporations experiencing a reduction in tax liability falls from 44% to 28% of the total.

Taxpayers who's taxes...	% Share under Current Law	% Share under Single Sales
Increase	32%	47%
Decrease	44%	28%
are Unaffected	24%	25%

(Revised) *Motion Picture/Audio Production Sales Tax Exemption:* The loss in Sales Tax revenue from the exemption provided in the bill is expected to be $80,000 in FY 2006 because of the January 1, 2006, effective date. The loss of Sales Tax revenue is estimated to be approximately $195,000 in FY 2007 and $205,000 in FY 2008. The net revenue impact of the Sales Tax exemption depends on the extent that collections on taxable activities attributable to new motion picture and audio production work in the state deviates from the revenue foregone due to the exemption. However, if the motion picture and audio production work would have occurred in the absence of the Sales Tax exemption, the net impact would be the total revenue foregone due to the exemption.

The bill provides that any tangible personal property purchased for direct use in a "motion picture or audio production, whether pre-production, production, or post-production work, in Indiana is exempt from Sales Tax. The bill defines a motion picture or audio production as the products described in (1) or (2) below produced for any combination of theatrical or television viewing, other media broadcast, or as a television pilot.

(1) A feature length film, including a short feature and an independent or studio production, or a documentary.

(2) A television or radio series, program, or feature.

The bill does not allow the exemption for motion pictures that are obscene (under the standard set forth in IC 35-49-2-1) or television or radio coverage of news or athletic events. In addition, the bill specifies that the following are not considered to be directly used in the production of a motion picture or audio production: (1) food services; (2) a vehicle used to transport actors and crew; (3) gasoline used in a vehicle used to transport actors and crew; (4) lodging.

Sales Tax revenue is deposited in the: Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%).

Hoosier Business Investment Tax Credit (HBITC): The bill makes the following two changes relating to the HBITC.

(1) The bill extends the sunset date for the HBITC by five years from December 31, 2007, to December 31, 2012. This would allow for new credits to be awarded by the IEDC for qualified investment occurring from 2008 to 2012. The bill also provides for automatic five-year extensions of the sunset date beginning December 31, 2012, unless legislation terminating the automatic extension is enacted. The potential amount of new credits that might be certified by the IEDC beginning in 2008 is indeterminable, with the fiscal impact of 2008 credits potentially beginning in FY 2009. A total of $331.7 M in new credits was awarded in 2004 (the first year of HBITC), and $149.6 M in new credits were awarded in 2005.

(2) The bill eliminates the deadline for creditable investment in machinery, equipment, or special purpose buildings used to make motion pictures or audio productions. The HBITC was extended to this type of investment effective May 15, 2005, but qualified investment must be made before January 1, 2008. The bill eliminates this deadline. The potential amount of new credits that might be certified by the IEDC for investment arising after the current deadline is indeterminable. The amount of new credits awarded in 2005 for qualified investment relating to motion picture or audio production is unknown at this time.

Background: Under current statute, the IEDC Board is authorized to award the nonrefundable HBITC for expenditures on qualified investment determined to foster job creation and higher wages in Indiana. The tax credit is equal to 10% of the qualified investment. (Note: The maximum allowable credit was 30% of qualified investment if approved before May 15, 2005.) A taxpayer may claim the credit against the AGI Tax, Insurance Premiums Tax, or Financial Institutions Tax liability. The tax credit may be approved only for qualified investment made during tax years 2004 to 2007. The credit is nonrefundable and may not be carried back. Unused tax credits may be carried over for up to nine years after the year in which the investment is made, unless a shorter carryover period is stipulated by the IEDC Board. A total of $331.7 M in new credits was awarded in 2004 for 54 projects consisting of $1,106.1 M in qualified investment. In 2005, $149.6 M in new credits was awarded for 58 projects consisting of $578.4 M in qualified investment.

Revenue from the corporate AGI Tax, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. Revenue from the individual AGI Tax is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Indiana Economic Development Corporation; Department of State Revenue.

Local Agencies Affected:

Information Sources: Claudia Ontiveros-Fuentes, IEDC, (317) 234-0616; Gretchen White, IEDC, (317) 234-3997; Economic Research Associates, *Economic Impact Analysis of Indiana's Film and Video Production Industry*, March 2003.

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